No. 6849

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

PACIFIC MIDWAY OIL COMPANY,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

BRIEF FOR APPELLANT.

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STATEMENT OF CASE.

This is an action brought by the Government to recover from appellant interest in the amount of $4,384.72 paid incidental to the refund of income taxes for 1917, 1918 and 1919. There was also a count for recovery of an alleged erroneous refund of taxes for 1921 but this has been abandoned.

The appellant denied any liability for the amounts sued for and in addition counterclaimed for an amount in excess of the Government's claim.

The District Court granted judgment for appellee in the amount of $3,495.28 (R. 38) and denied appellant's counterclaim. This appeal was taken from the judgment in favor of appellee and the denial of the counterclaim.

THE FACTS.

On March 15, 1921, the appellant filed its income tax return for 1920 and paid on that date the tax of $1,644.39 shown thereon to be due. On November 10, 1926 it paid to the Collector of Internal Revenue an additional amount of $85,000.00 on account of its 1920 tax liability. The Collector accepted this payment and immediately cashed the check.

On December 31, 1926, the Commissioner of Internal Revenue issued a notice of deficiency as required by Section 274 (a) of the Revenue Act of 1926 indicating an underassessment of tax for 1920 of $86,577.19. This amount was assessed against the appellant on January 22, 1927 plus interest of $3,676.56.

On January 31, 1927, the Commissioner allowed overassessments of tax for the years 1917, 1918 and 1919 aggregating $22,025.93 and forwarded a schedule of them to the Collector for ascertainment as to whether there were any taxes of the appellant then due to which these amounts should be credited. The Collector upon searching his records found only $1,577.19 ($86,577.19 additional assessment less $85,000.00 payment) tax and $3,676.56 interest for the year 1920 remaining unpaid on the appellant's account and after applying a sufficient portion of the overassessments to offset these amounts, certified the balance back to the Commissioner as refundable. The Commissioner, in April, 1927, refunded to appellant the balance with interest.

Thereafter on February 17, 1928, the Commissioner allowed a refund of tax for 1920 of $11,875.56 but

instead of refunding the entire amount, he withheld $4,348.72 with the explanation that it was retained on account of the prior erroneous allowance of interest on the refunds for 1917, 1918 and 1919.

The Government then brought this suit presumably to justify the withholding of this money but actually praying for an affirmative judgment for a like amount.

ISSUES INVOLVED.

The complaint fails to state a cause of action.

The principal issue presented is whether the Commissioner of Internal Revenue acted contrary to law in refunding certain admitted overpayments of taxes with interest.

The judgment as entered is improper in that it grants judgment to appellee for money it admittedly already has and fails to grant judgment to appellant for the excess of money held by appellee over that allowed by District Court's decision.

If this court finds that original action of Commissioner was according to law then appellant is entitled to interest on that part of the 1919 overassessment credited against the interest assessed on the 1920 deficiency.

BRIEF OF ARGUMENT.

I. Suit was brought to recover an amount which is being withheld by appellee. Under such circumstances the appellee is without a cause of action.

II-III. The court below held that the action of the Commissioner in refunding certain overpayments with interest was illegal. The Commissioner's acts are presumed to be lawful and the burden of proving the contrary has not been sustained. The effect of the court's decision is to deny taxpayers the right to voluntarily pay taxes in advance of assessment in order to avoid the accumulation of interest and in its efforts to find a reciprocal arrangement for the payment and collection of interest on refunds and additional assessments the court improperly interpreted the law.

IV. An overpayment of taxes for 1919 made in 1921 and allowed as an overpayment in 1927 was applied against interest assessed in 1927 on a 1920 deficiency. The interest assessed did not become due until assessed in 1927 and the Commissioner was in error in failing to allow interest on the 1919 overpayment from 1921 until the assessment of interest in 1927.

V. Regardless of how this court may view the other issues, the appellant is entitled to an affirmative judgment for that part of the overpayment allowed for 1920 which is being withheld by the Government in excess of the amount held recoverable by the lower court. The Government concedes it is withholding $4,384.72 from appellant. The court below gave judgment for $3,495.28. In order to insure appellant that it will be able to recover the difference admittedly due it, the judgment should be directed in favor of appellant for $889.44. Otherwise if the Government fails to return this amount the appellant would be

without recourse to enforce payment in event the defense of *res adjudicata* is interposed.

ARGUMENT.

I. THERE IS NO CAUSE OF ACTION SHOWN.

The Government concedes that it allowed an overpayment of taxes and interest for 1920 of $11,875.56 but refunded only $7,490.84 withholding $4,384.72 to satisfy its alleged claim for prior erroneous refund of interest which is the basis of this action and for which it seeks judgment.

Manifestly the claim of the Government was satisfied before the action commenced and there remains no redress that could be extended to it by this court. Its suit is without merit and should have been dismissed.

II. THE COMMISSIONER COMMITTED NO ERROR IN ORIGINALLY REFUNDING OVERPAYMENTS WITH INTEREST.

a. Acts of Commissioner are presumed to be in accordance with the law.

The Commissioner allowed certain overassessments and after applying part of them as a credit, refunded the balance with interest. Subsequently the Government decided that this action of the Commissioner was erroneous and now seeks the recovery of the interest refunded. Just why recovery of only the interest is sought although the pleadings allege the entire action of the Commissioner to have been er-

roneous appears to be an inconsistency upon which the record casts no light.

When the Commissioner made the refunds that the Government now alleges to have been erroneous, he is presumed to have acted in accordance with the law[1]. The Government, as plaintiff, had the burden of proving the Commissioner acted contrary to law. Not only did it fail to meet this burden, but the pleadings and evidence sustain the legality of the Commissioner's action.

b. Refunds were made in accordance with the law.

Section 284 (a) of the Revenue Act of 1926, which is the governing statute, provides that:

> "Where there has been an overpayment of any income, war-profits or excess-profits tax * * * the amount of such overpayment shall be credited against any income, war-profits, or excess-profits tax or installment thereof *then due* from the taxpayer, and any balance of such excess shall be refunded immediately to the taxpayer."

In this case the Commissioner's determination that overpayments existed was made January 31, 1927. In pursuance of the provisions of Section 284, he forwarded a schedule of the overassessments to the Collector for the purpose of noting thereon any other taxes of the taxpayer "then due." The Collector reported back that there remained unpaid only $1,577.19 tax and $3,676.56 interest. Overassessments to this

1. *Trustees of Ohio & Big Sandy Oil Co. v. Commissioner*, 9 B. T. A. 617, 625-626, and cases cited; *Pantages Theater Co. v. Lucas*, 42 Fed. (2d) 810, 812; *United Thatcher Coal Co. v. Commissioner*, 46 Fed. (2d) 231, 233; *Washington Post Co. v. Commissioner*, 10 B. T. A. 1077, 1080; *Griffen v. American Gold Mining Co.*, 136 Fed. 69; *Gonzales v. Ross*, 120 U. S. 605, 616.

extent were applied as a credit and the balance was refunded to the taxpayer with interest.

Assuming these facts to be correctly stated, it is obvious that the action of the Commissioner was proper and there is no justification for holding it to have been erroneous. And there can be no question of the accuracy of these facts as they are taken from the Government's complaint. (R. 7.)

c. Payment of $85,000.00 on November 10, 1926 was a valid payment of 1920 taxes.

Paragraph XIV of the complaint (R. 9) appears to contain the only explanation of the Government's basis for recovery in the allegation that the overassessments should have been credited against the additional assessment for 1920. This is interesting but somewhat confusing as there is found nowhere in the Revenue Act of 1926 any authority or direction for applying overassessments against additional assessments.

Apparently the Government intends to argue that the payment of $85,000.00 on account of 1920 taxes on November 10, 1926 should be disregarded. Such a contention would amount to denying a taxpayer the right to pay his taxes at any time after they became due.

A taxpayer's liability to pay the tax on his income becomes fixed at the close of the taxable year[2]. The tax becomes due and payable under the statute at the

2. *Fawcus Machine Co. v. United States*, 282 U. S. 375; *United States v. Yale & Towne Mfg. Co.*, 269 U. S. 422; *United States v. Woodward*, 256 U. S. 632.

time the return is filed[3]. The full amount of tax on the appellant's income for 1920 became due and payable on March 15, 1921, when its return was filed, regardless of the fact that the return indicated a much smaller amount than the tax actually due. The appellant was at all times thereafter under legal obligation to pay its 1920 tax.

Furthermore the appellant had a legal right to pay its tax at any time, whether or not any steps were taken by the Commissioner to collect it by assessment or otherwise. Assessment is not a necessary prerequisite to collection of a tax[4]. Nor have we been able to find any authority to the effect that assessment is a necessary prerequisite to voluntary payment by a taxpayer. While not directly in issue, the Court of Claims in *Royal Bank of Canada v. United States,* 70 Ct. Cl. 663, 44 Fed. (2d) 249, expressly recognizes the right of a taxpayer to make payment prior to assessment, and allows recovery of interest from the date of such payment.

By payment of $85,000.00 on November 10, 1926, upon account of 1920 income taxes, the appellant sat-

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3. In the case of taxes for 1920 imposed by the Revenue Act of 1918, see section 250(a), (b), (e), and Regulations 45, Arts. 1001, 1003. For the due date under later Revenue Acts see section 250 of the Revenue Act of 1921 and Art. 1001 of Regulations 62, section 270 of the Revenue Acts of 1924 and 1926 and Art. 1201 of Regulations 65 and 69. section 56 of the Revenue Acts of 1928 and 1932 and Art. 431 of Regulations 74.

4. *Dollar Savings Bank v. United States,* 19 Wall. 227; *United States v. Ayer,* 12 Fed. (2d) 194; *United States v. Kelley,* 24 Fed. (2d) 234, rev. on other ground, 30 Fed. (2d) 193; *United States v. Greenfield Tap & Die Corp.,* 27 Fed. (2d) 933; *United States v. Cruikshank, et al.,* 48 Fed. (2d) 352; Regs. 45, Art. 1008, applicable to 1920. Since enactment of the Revenue Act of 1926 a statutory notice of deficiency must be mailed under section 274(a) before proceeding for collection can be begun. But this provision still does not make formal assessment a prerequisite to collection. *O'Cedar Corporation v. Reinicke,* not yet published, decided July 26, 1932, by the District Court, Eastern District of Illinois, C. C. H., Standard Federal Tax Service, Par. 9434.

isfied to that extent its legal obligation to the Government. The Collector accepted the payment as a payment of 1920 taxes and issued a receipt so stating. (R. 44.) Neither the Collector nor the Commissioner could have treated this payment as a payment on account of taxes for any other year. Neither could they disregard this payment in the collection of further taxes for 1920.

And further the record shows conclusively that this payment was not disregarded. Throughout the entire interest computations including those upon which this action is based the Government computes interest charges taking into consideration this payment as made on November 10, 1926. And we are aware of no effort ever having been made to return it to the appellant which would seem to have been the plausible disposition of it if the Government decided it was not acceptable.

There appears to be no basis for disregarding this payment and if it is not disregarded we find that even upon the theory of applying overassessments against additional assessments there is no ground for holding in favor of the Government. On January 22, 1927, the Government made an additional assessment for 1920 of $86,577.19, with interest of $3,676.56. On November 10, 1926, nearly three months prior, the taxpayer had paid up $85,000.00 of that additional assessment. On January 31, 1927, the overassessments were allowed. Obviously on January 31, 1927, there only remained of the additional assessment the difference between the amount assessed and the amount paid up, and there was no way that the Commissioner could

in the face of these facts apply more of the overassessments than would absorb this difference. This he did and his action seems to have been proper.

d. Preliminary notice prior to assessment not a final determination.

From a reading of the appellee's reply brief filed in the lower court we gather another indication of the position that will probably be advanced by the Government. It states that the determination of the deficiency is alleged to have been made on November 10, 1926, in Paragraph VIII of the complaint and that this is admitted in the answer. The lower court was apparently somewhat influenced by this inadvertence of Government counsel, and I would like to call attention to this court that the amended answer contains no such admission.

The Commissioner made his "determination" on December 31, 1926. (R. 12-14, Exhibit No. 1.) Any correspondence which the appellant may have received prior to the letter of December 31, 1926, was not a "determination of a deficiency" within the meaning of Section 274 (a) of the Revenue Act of 1926.[5] Nor did any such correspondence amount to an "allowance" of the overassessments prior to the allowance of January 31, 1927. Any notice received from the Commissioner indicating that he found taxes overassessed prior to the actual allowance on January

5. *Appeal of Terminal Wine Co.*, 1 B. T. A. 697, 701; *Appeal of New York Trust Co., et al., Executors*, 2 B. T. A. 583, 586; *Miami Metals Co. v. Commissioner*, 10 B. T. A. 421, 426; *United States ex rel. Dascomb v. Board of Tax Appeals*, 16 Fed. (2d) 337.

31, 1927, was without legal effect.[6] The allowance of an overpayment is not made until the proper formal action is taken by the Commissioner in signing a schedule of refunds or credits.[7] It is only after the formal "allowance" of an overpayment that the taxpayer has a claim against the Government on which suit can be brought.

It is manifest from the record here that on November 10, 1926, there had been no official "determination" of a deficiency nor any "allowance" of overassessments. No action had been taken by the Commissioner that created a definite status between the Government and the taxpayer. His letter of November 10, was merely tentative in character and did not render the proposed deficiency "prima facie" due as would a statutory determination such as the letter of December 31, nor did it extend any rights to the taxpayer with regards to the overassessments upon which it might found a suit.

e. Decision of lower court.

Apparently the lower court considered the Commissioner's letter of November 10, 1926, as a final statu-

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6. The record does not show that the appellant had any such notice at the time the $85,000.00 payment was made. It could not have received the letter (not introduced in evidence) alleged to have been mailed from Washington, D. C.. on the same date, and the supposition indulged in by the court below that the appellant had a representative in Washington who kept it advised is entirely unsupported by any kind of evidence. In fact the record shows that the check was dated November 9, 1926, and presumably was drawn on that date. (R. 43.)

7. *Bonwit Teller & Co. v. United States*, 283 U. S. 258; *Western Shade Cloth Co. v. United States*, 58 Fed. (2d) 863 (Adv. Shts.). Also cf. following language in G. C. M. 8902, IX-2 C. B. 222, 223: "When it is determined that a tax is overpaid—that is, when the Commissioner approves the schedule of refunds and credits—the liability of the Government to refund or credit the amount so overpaid becomes fixed and determined, and the right of the taxpayer to such interest as is allowed by the statute likewise becomes fixed and determined."

tory notice of deficiency and an allowance of the over-assessments in arriving at its decision as only by so doing could it have considered the authorities cited to be controlling. Reference to these cases will show that there is a factual distinguishment with the case at bar in that in each the court is referring to a notice of deficiency as provided by law and not to such a preliminary notice as that of November 10, 1926.

In the *McCarl v. Leland*[8] case the Commissioner had sent a final deficiency letter notifying the taxpayer of a deficiency for one year and an overpayment for another. An appeal was taken to the Board of Tax Appeals and while it was pending the Commissioner authorized refund of the overpayment. The Comptroller General refused to certify the overpayment and the taxpayer petitioned for a writ of mandamus. The court held that although the deficiency could not be collected until the proceedings before the Board were concluded, yet the determination of the Commissioner was *prima facie* correct and the deficiency must be considered "then due." Under such circumstances the overpayment was not refundable under Section 284 (a) of the 1926 Act. The same principal was involved in *Tull & Gibbs, Inc., v. U. S.*[9] in that a refund was asked while an appeal was pending before the Board.

In the case here the appellant not only had not appealed to the Board on November 10, 1926, but no action of the Commissioner was taken prior to December 31, 1926, from which an appeal would lie.

8. 42 Fed. (2d) 346 Cert. den. 282 U. S. 839.
9. 48 Fed. (2d) 148.

In *York Safe and Lock Co. v. U. S.*,[10] a statutory letter of final determination was issued June 26, 1926, notifying of a deficiency and an overassessment. The taxpayer did not appeal within the 60 days allowed and after expiration of that period delivered to the Collector a check for the deficiency. It was held that the deficiency had become due and the overpayment should have been applied as a credit against it before applying the tendered payment.

However, the court stated in its opinion that a different conclusion would have been reached had the facts been similar to the facts of this case. The court said:

> * * * Had the plaintiff discovered the deficiency in tax for 1918 and paid it before the Commissioner made his determination and notified plaintiff on June 26, 1926, the entire overpayment for 1919 would have been refundable with interest.

This appellant discovered a deficiency in its 1920 tax as early as August 14, 1924 (R. 4), and paid it nearly two months before the notice of December 31, 1926, which notice is the one comparable with that of June 26, 1926.

The lower court further misconstrued the York case when it says that it expressly leaves open the question here. The question expressly left open in the *York* case was what the result would have been if the payment of the deficiency was made after the notice of June 26, but before the 60-day period for appeal had expired. In this case that question is not presented

10. 40 Fed. (2d) 148.

as the payment was made before the 60-day period had commenced.

Had the lower court noted the factual differences between the case at bar and the authorities referred to it, it is probable that its opinion would have been to the contrary.

III. INEQUALITY IN THE INTEREST PROVISIONS OF THE LAW IS NOT CONTROLLING.

If a proper application of the law works to the disadvantage of either party, it is to be regretted, but it is not the province of the courts to arbitrarily apply taxing statutes contrary to their express provision in order to effect a more equitable result in particular cases.

There are numerous instances of inequality in the payment and collection of interest which cannot be remedied by judicial interpretation. Probably the most glaring difference was created by the provisions of Section 319 of the Legislative Appropriation Act recently enacted (Public No. 212, 72d Cong., 1st Sess.), which allows interest on refunds at the rate of 4%, while the Government still collects interest on underpayments at the rate of 6% to the date of assessment, and at 12% if not paid within ten days after notice and demand.

The provisions of law are clear. Congress expressly provided that interest should be paid on refunds and collected upon unpaid taxes for certain periods. There is nothing reciprocal about those provisions and there

is no basis for any court to attempt to work out reciprocity on the ground of the intent of Congress.

IV. APPELLANT IS ENTITLED TO INTEREST ON THAT PART OF THE 1919 OVERPAYMENT WHICH WAS CREDITED IN PAYMENT OF 1920 INTEREST.

The Commissioner allowed an overpayment of $7188.62 for 1919. He credited $1577.19 against unpaid 1920 tax and $3676.56 against interest assessed on the 1920 deficiency and refunded the balance. No interest was allowed on the $3676.56 overpayment of *tax* credited against *interest* on the 1920 additional assessment. In its counterclaim the appellant asks for interest on this amount from the date its 1919 tax was paid, April 23, 1921, to the date of the credit. The appellant is entitled to this only in event this court finds that the overpayments were properly made in the first instance.

This question was disposed of in the affirmative in *Moore Shipbuilding Co. v. United States.*[11] In that case an overpayment of tax was credited against an *ad valorem* penalty instead of interest as in this case. But the principle is the same. The credits were both made under Section 1116 of the 1926 Act, which allows interest on credits to the due date of the amount against which an overpayment is credited. An interest assessment, like the penalty assessment, becomes due only when assessed.

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11. 50 Fed. (2d) 288.

Interest should be allowed on the $3676.56 from April 23, 1921, to January 31, 1927, the due date of the interest against which it was credited.

V. APPELLANT IS ENTITLED TO AFFIRMATIVE JUDGMENT FOR AMOUNTS DUE IT.

The Government is suing to recover an amount alleged to have been erroneously paid to appellant. Entirely independent of its claim for recovery, the Government admits that it is withholding from appellant the sum of $4384.72, which is legally due appellant as refund of taxes overpaid for another year.

The court below entered judgment for the Government for $3495.28 and failed to enter judgment for appellant for the $4384.72 admittedly due it. This was error.

If the decision of the court below is sustained in principle, its judgment should be modified to include judgment for appellant for $4384.72 on its counterclaim, or it should be modified to give judgment for the appellant for $889.44, the net amount still due it after allowing for the amount found to be due the Government.

In its present form, the Government can have execution on its judgment and recover from appellant the sum of $3495.28. The judgment is only an adjudication of the appellee's claim for interest, and not an adjudication of appellant's claim for money admittedly due it.

The right of the appellant to money due it is put in issue by its counterclaim. Unless it is given af-

firmative relief in this proceeding, it would be precluded by the doctrine of *res adjudicata* from proceeding in another action to recover from the Government. Unless given judgment for the amount due it, the appellant will be thrown upon the benevolence of the Commissioner of Internal Revenue.

CONCLUSION.

This case should be reversed and remanded to the District Court with directions to enter judgment against the appellee on all counts in its complaint, and to enter judgment for the appellant for the sum of $4384.72 illegally withheld from it by the Commissioner of Internal Revenue, plus $1274.00 interest on that portion of the 1919 tax credited against the 1920 interest assessment, and the further sum of $85.26 already conceded to be due the appellant, together with interest on such sums as provided by law, and such other relief as seems just.

Dated, San Francisco, California,
November 9, 1932.

Respectfully submitted,

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